Joint Statement and Testimony of Noticing Distributors

Joint Statement of Noticing Distributors

- Warren Rural Electric Cooperative Corporation
- Monticello Electric Plant Board
- Glasgow Electric Plant Board
- Paducah Power System
- Princeton Electric Plant Board
- Duck River Electric Membership Corporation

Written Testimony of Panelists

- Gerald R. Hayes, Warren RECC
- John A. Humphries, Princeton EPB
- Raymond E. McLennan, Paducah Power System
- James M. Allison, Duck River Electric MC

Additional Written Testimony

- William J. Ray, Glasgow EPB

TVA Board Hearing
May 18, 2006
Hopkinsville, Kentucky

Joint Statement of Noticing Distributors

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The Noticing Distributors wish to welcome the newly expanded TVA Board to Kentucky. We thank you for the opportunity to have representatives of the Noticing Distributors appear before you at this hearing. To supplement the individual oral and written statements, we offer this joint statement on behalf of all six Noticing Distributors.

Executive Summary of Noticing Distributors' Position and Needs

The Noticing Distributors respectfully request that the new TVA Board immediately approve the plan developed jointly by TVA senior management, TVPPA and the Noticing Distributors (the "Joint TVPPA Plan," "TVA-TVPPA Plan" or "TVPPA Framework," a copy of which is attached). **We urge the Board to authorize and direct TVA's management to implement this Joint Plan through contracts between TVA and its distributors.** Because of the urgency of pending financial decisions and commitments facing the Noticing Distributors, we ask that TVA's management be directed to make every reasonable effort to complete the negotiation of those contracts, at least for the Noticing Distributors and preferably for all distributors, within sixty days.

The Joint TVPPA Plan represents a compromise developed over many meetings and months. While there are elements that the Noticing Distributors would prefer were not included, it is the product of good faith give and take among all interested stakeholders. **The main thing that the Noticing Distributors need—and would get under the Joint Plan—is assurance that they will be able to obtain transmission access to, and/or interconnection with, the TVA transmission grid on just and reasonable rates, terms and conditions.** This is essential for the Noticing Distributors to realize the promise that in our view was given by TVA in the 1997 wholesale power contract amendment. The promise was that distributors who signed the amendment and waited at least five years before giving five years' notice of termination would be able to terminate their TVA contract and purchase their power from other suppliers in the competitive wholesale electricity market.

The Joint TVPPA Plan contains important benefits for TVA and TVPPA members who choose to continue to buy power from TVA as well. It is genuinely a "win-win-win" achievement. The Noticing Distributors wish to thank TVA's Acting CEO, Tom Kilgore, and General Counsel, Maureen Dunn, as well as TVPPA's Board President, John Williams, other TVPPA participants, and TVPPA's Executive Director, Jack Simmons, for the leadership and insights that they and their staffs brought to this effort.

Who are the Noticing Distributors?

The Noticing Distributors are five of the six TVA distributors whose Wholesale Power Contracts with TVA are currently scheduled to terminate. Each Noticing Distributor gave five years' notice of termination in accordance with the terms of the contracts. They are:

Noticing Distributor	Leadership	Contract Expiration
Warren Rural Electric Cooperative Corporation Bowling Green, KY	Gerald W. Hayes, President and CEO Kenneth H. Robbins, Board Chmn	April 2008
Monticello Electric Plant Board Monticello, KY[1]	Gary Dishman, CEO Michael Anderson, Board Chmn	November 2008
Glasgow Electric Plant Board Glasgow, KY	William J. Ray, Superintendent Robert A. Lessenberry, Board Chmn	December 2008
Paducah Power System Paducah, KY	David R. Clark, General Manager Raymond E. McLennan, Board Chmn	December 2009
Princeton Electric Plant Board Princeton, KY	John Humphries, P.E., Superintendent Rickie W. Williams, Board Chmn	January 2010
Duck River Electric Membership Corporation Shelbyville, TN	James M. Allison, General Manager Brent Willis, Board Chmn	August 2010[2]

The six noticing distributors collectively represent only approximately 2.7% of TVA's total electric sales, based on data for the fiscal year ending June 30, 2004. This is less than one year's normal load growth on the TVA system. According to TVA's 2005 Information Statement, dated November 18, 2005, TVA's sales to the six distributors in 2005 represented 2.9% of TVA's operating revenues. Thus, even if all the current noticing distributors departed simultaneously, the impact on TVA's load and revenues would be small. As the table above demonstrates, their contracts expire over a period of more than two years, which further minimizes any impact on TVA of the potential loss of load.

[1] Monticello EPB has given notice of termination of its contract and is a co-sponsor of this Joint Statement, but is not a regular participant in the Noticing Distributors group.

[2] Duck River Electric's original contract termination date of August 2008 was extended two years by agreement with TVA.

Decisive Action by the TVA Board is Urgently Needed

With contracts expiring as early as April 1, 2008, in the case of Warren RECC, **it is of utmost importance that the TVA Board act immediately (1) to approve the Joint TVPPA Plan and (2) to direct TVA's Management to work with the distributors to develop contracts within sixty days for its implementation**. The Noticing Distributors have the greatest need for swift action and would therefore request that if more time is required to develop the contracts for the non-noticing distributors, contracts for at least the Noticing Distributors be readied for formal approval within sixty days.

As will be described in greater detail in the testimony of individual Noticing Distributors, their situation is the most urgent. Some of them have already made substantial financial commitments in order to be prepared to obtain power supply from non-TVA sources by the end of the five-year termination notice period. Others must make critical decisions and commitments in the near future. It is absolutely imperative that the uncertainty that has surrounded the transmission access[3] issue be resolved now, because substantial investments and commitments are being jeopardized by delay and inaction. These distributors gave notice of termination in good faith, relying upon their rights to do so under their contracts with TVA.

The Joint TVPPA Plan is the culmination of months of negotiations, analysis and review. Many of the issues addressed in the Plan have been under discussion for literally years. After legislation was introduced in the United States Senate last summer by Senators McConnell and Bunning that would have assured transmission access for most of the Noticing Distributors, we understand that TVA requested that no action be taken on the legislation for six months (from September 1, 2005 until March 1, 2006). The purpose of this hiatus was to give the parties time to develop a resolution of the issues that would not require legislation. Intensive negotiations began last fall with the leadership and direction of the highest levels of management of TVA and TVPPA, as well as participation by representatives of the Noticing Distributors. A working group (or "steering committee") of top level principals met repeatedly to develop the details of a plan that would meet the needs of all stakeholders.

Unfortunately, the March 1 deadline or target came and went without resolution, but the good news is that the parties continued to work together to hammer out the Joint TVPPA Plan that addresses everyone's needs. However, with the added delay, there is now no time to waste. One of the reasons for delay was to give the new TVA Board the opportunity to review the Plan. The Noticing Distributors welcome the review by the new Board, but hope that the Board will take into consideration the extensive effort that has gone into crafting this Plan and the crucial need for swift action for the benefit of all concerned.

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[3] By "transmission access" we mean the availability of transmission service over the TVA grid at just and reasonable rates, terms, and conditions consistent with the standards in sections 211, 205 and 206 of the Federal Power Act and interconnection rights in accordance with section 210 of the Federal Power Act, with waiver by TVA of all rights and arguments based on the anti-cherry-picking provision of section 212(j).

The Joint TVPPA Plan Makes Good Business Sense for TVA

The Joint Plan has many advantages for TVA that are probably obvious, but we summarize here our perspective on why approval of the Plan would be an exercise of sound business judgment. The Board has an opportunity to establish a new, forward-looking course for TVA that will move it from a defensive posture, which in the past has relied heavily on monopoly control of transmission, to a pro-active approach, which will help TVA earn the voluntary support and loyalty of its distributors and other customers by embracing more market-oriented principles. Some of the Plan's advantages are the following:

- **The Plan has broad support from all stakeholders**

The Plan is the product of an effort by Senior Management of TVA and TVPPA to develop a contractual solution to the issues surrounding transmission access and the need to offer more market-oriented options that would be attractive to distributors who elect to remain with TVA, while maintaining the financial and operational integrity of TVA. Early in the process, the Noticing Distributors were also invited to participate. The Plan addresses the needs—and has the support—of all of the affected stakeholders. It represents a consensus reached through good faith negotiations and a willingness of all parties to recognize and be responsive to the needs of the others.

- **The Plan is consistent with TVA's mission**

At various times through its seven-decade history, TVA's Board and Management have demonstrated visionary leadership in pursuit of TVA's mission to be a positive economic stimulus and model corporate citizen of the Tennessee Valley in which it serves. The Joint TVPPA Plan offers the opportunity to begin a new chapter in the dynamic relationship between TVA and the electric power distributors in its region, consistent with TVA's goals of fostering economic development and supporting communities.

- **The Plan protects and strengthens TVA's financial position**

By facilitating TVA's transition into a more pro-competitive approach to its relationship with its distributors, the Plan positions TVA to increase the support and loyalty it receives from its distributors. By embracing the Plan's creative approaches to the ownership of generation resources and to making available new services, such as partial requirements electric service for interested distributors, TVA should be better able to offer an array of attractive options to its distributors on an economically sound basis. This should promote a healthier long-range financial position for TVA, because its new relationships with distributors will be the product of voluntary choices, rather than dependent upon the exercise of monopoly control over the transmission grid.

The Plan leaves untouched TVA's broad discretion to set its power rates in accordance with the requirements of the TVA Act, thereby assuring continuing financial strength. It places limits on the total amount of load that could obtain transmission service for import of power from non-TVA suppliers, so that any such loss of load can be easily absorbed through growth in other TVA load. Since TVA's power generation resources are currently stretched, allowing a controlled amount of load to obtain economical resources from other suppliers can be economically beneficial to TVA and the region. It is also entirely possible that the load actually lost by TVA will not even approach the levels of the limits, so that the entire question of the economic impact of "lost" load may become moot. TVA has many loyal distributors that have shown no intention to seek power from outside suppliers, and approval of the Plan will provide those distributors even more reasons to be satisfied with TVA as their power provider.

Another element of the Plan is that TVPPA and the Noticing Distributors will actively support legislation to allow TVA to sell power to prospective purchasers outside the existing "fence" in addition to those to whom TVA is currently permitted to sell. This "megawatt-hour for megawatt-hour" gradual lowering of the fence, if enacted, will enable TVA to access new markets, if it chooses, to replace any loads that elect to purchase power from non-TVA sources. However, this element of the Plan is the only piece that would require Congressional action and, due to time constraints and the political uncertainty that always accompanies legislative proposals, the remainder of the Plan should not be held in abeyance awaiting such approval. The Plan is advantageous to all parties even with the outcome of this item remaining uncertain for the time being.

➢ **The Plan avoids Congressional imposition of remedies**

An advantage of implementing the Joint TVPPA Plan is that it will remove the impetus for Congressional action to assure transmission access for distributors. Last summer, United States Senators McConnell and Bunning of Kentucky introduced legislation that would have eliminated the "anti-cherry-picking" limitation on the authority of the Federal Energy Regulatory Commission to order access to the TVA grid for distributors in Kentucky. Since that bill's introduction, discussions have been held regarding possible amendments to expand its reach beyond just Kentucky. While the Noticing Distributors greatly appreciate the ongoing interest and support given by these Senators and others in Congress who have provided leadership on these issues, we also recognize that a solution crafted by consensus among the affected stakeholders can be preferable to the imposition of potentially rigid or piecemeal remedies through legislation. As noted, the Plan limits the availability of transmission access to a measured, controlled limit that protects TVA against the possibility of a sudden large loss of load, which might or might not be a feature of any non-consensus solution.

➢ **The Plan avoids litigation and the potential imposition of remedies on TVA by FERC or the Courts**

The Joint TVPPA Plan also has the advantage of eliminating the prospect that TVA could face far less favorable remedies that may be imposed by FERC or the Courts. With the clock ticking on their termination notice periods and the time required to pursue relief through litigation, the pressures on the Noticing Distributors to obtain relief will intensify if the Joint TVPPA Plan is not approved immediately. This is not intended to be viewed as a threat, but the alternatives available to the Noticing Distributors are limited. Much attention and effort has been concentrated since last fall on developing the Joint Plan, which was intended to avoid the need for further litigation.

While recognizing the likelihood that TVA would vigorously contest any lawsuits or complaints filed, the Noticing Distributors believe that there are solid legal grounds for remedies to be ordered by the Courts and FERC. Again, we hope it will not be necessary to go further down that road, but to provide a context for the TVA Board's deliberations on the Joint TVPPA Plan, we summarize some of the potential actions.

First, the Noticing Distributors believe that in the 1997 contract amendments, TVA implicitly promised that it would make its transmission grid available for distributors who gave notice of termination in accordance with the contract requirements. It is difficult to square TVA's promise that distributors would have the right to terminate their contracts and purchase power from non-TVA sources (conditioned on their continuing to buy all of their power from TVA for at least ten more years) with a position that TVA could turn around and frustrate that right by refusing to make the necessary transmission service and interconnections available. The contract provision that spells out that the distributors will have fulfilled all obligations to pay so-called "stranded costs" by staying with TVA for the required ten-year minimum period is particularly telling. Section 4(a) of the amendment precludes TVA from imposing a stranded cost charge in any form on departing distributors who meet the notice requirements, and specifically provides that no such charge shall be included in "wire surcharges, transmission surcharges, or terms having similar effect ...." The clear implication is that the parties anticipated that TVA would be providing and charging for transmission services. Courts generally take a dim view of a party to a contract that refuses to take the necessary actions to permit the purpose of the contract to be achieved.

The Federal Energy Regulatory Commission has authority to require TVA to provide transmission services under section 211 of the Federal Power Act, subject to certain exceptions. The principal exception of importance in this context is found in the "anti-cherry-picking" provision of section 212(j) of the Act. Section 212(j) provides that FERC may not issue an order under section 211 requiring transmission service by TVA if the electric energy to be delivered would be consumed within the statutory TVA area defined in section 15d(a) of the TVA Act.[4] For at least three of the Noticing Distributors (Glasgow EPB, Paducah Power System, and Princeton EPB), the anti-cherry-picking exception does not apply, because those systems are not inside the TVA statutory area, and therefore the energy to be transmitted to them would not be consumed within the protected area. Indeed, because they were outside the area boundary (sometimes referred to as the TVA "fence"), a special exception had to be included in section 15d(a) of the TVA Act to allow TVA to be able to sell to these three systems (and others) outside the "fence." This means that FERC can order transmission service under section 211 for

[4] It should be noted that there has never been any question that TVA has full authority to provide transmission service to distributors if it chooses to do so (as the Noticing Distributors submit TVA effectively did for those distributors who signed the 1997 wholesale power contract amendment). Section 212(j)'s restrictions apply only to FERC, not to TVA. TVA has repeatedly acknowledged that it has all the authority it needs to provide transmission service to distributors.

these distributors, just as FERC can do for other would-be users of the TVA grid, where the power is not to be consumed within the TVA statutory area.

FERC also has authority to require transmission service under the new section 211A of the Federal Power Act that was added by the Energy Policy Act of 2005. While we note that TVA has taken the position that Congress must have intended to expand the scope of the anti-cherry-picking provision of section 212(j) to apply to section 211A, it did not do so. Section 212(j) continues to refer only to orders issued by FERC under section 211 and does not mention section 211A. Thus, this is an additional avenue of potential relief from FERC that would be available to all Noticing Distributors (and, for that matter, other distributors who have not yet given notice of termination). Again, this is an example of the advantage to TVA of adopting the Joint TVPPA Plan, which would prevent the potential for an unrestricted flood of future departures of distributors exercising rights under section 211A.

A further avenue available to Noticing Distributors is to seek an order from FERC under yet a different provision of the Federal Power Act—section 210—to require the physical interconnection of TVA's transmission facilities with those of the distributor or new power provider. As the Board may be aware, this is the portion of the statute relied upon by East Kentucky Power Cooperative in an application that FERC has already granted to facilitate EKPC's power supply and delivery service to Warren RECC. FERC has rejected TVA's position that the anti-cherry-picking provision in section 212(j) should be applied in this context.[5]

As we are sure the TVA Board well understands, litigation is at best an uncertain proposition for everyone concerned, and carries the risk of unpredictable and unfavorable outcomes. The Noticing Distributors strongly believe that it is in the best interest of TVA, TVPPA and the Noticing Distributors to move forward with the agreed-upon Joint TVPPA Plan, rather than risking the imposition of less well-suited obligations by FERC or the Courts.

All in all, approval of the Joint TVPPA Plan will be an act of sound business judgment by the TVA Board with many advantages to TVA and to all of its distributors.

The Joint TVPPA Plan addresses the Noticing Distributors' need for transmission access at just and reasonable rates, terms and conditions

The Joint TVPPA Plan contains many elements, which we presume will be fully described by others, but the key provisions for the Noticing Distributors are those pertaining to TVA's providing of transmission access. Paragraph a. of the Plan provides for immediate transmission access waiver for current noticing distributors (i.e., the Noticing Distributors, including Monticello EPB), subject to certain conditions. This means that TVA will contractually waive its objections under the anti-cherry-picking provisions of section 212(j) of the Federal Power Act (and otherwise) and will provide

[5] TVA has filed a request for rehearing of FERC's final order in that proceeding.

transmission access for current noticing distributors upon expiration of their TVA contracts.

In effect, by TVA's having waived its section 212(j) objections, the Noticing Distributors will have the option either to purchase transmission service from TVA or to obtain interconnections with TVA facilities, depending on which approach is most suitable for the particular system, or both. Transmission service will be provided in accordance with the standards applicable under sections 205, 206, and 211 of the Federal Power Act,[6] which are the same standards that already apply to all other users of the TVA grid that are not subject to the limitations of section 212(j). As we understand TVA's position, its objection to providing or maintaining interconnections for East Kentucky Power Cooperative in the pending litigation has been premised, at least in part, upon an argument that EKPC was indirectly seeking transmission service under section 211, rather than interconnection and related coordination services under section 210.[7] Pursuant to the transmission access waiver in the Plan, that objection would no longer apply, and TVA would no longer contend that section 212(j) should deprive FERC of jurisdiction to order interconnection service. Again, this merely gives the Noticing Distributors the same rights that any other utility seeking interconnections with TVA already has under current law.

Another provision of the Plan that the Noticing Distributors hope will never need to be invoked, but is of key importance, states that if the parties are unable to agree on the rates, terms and conditions of transmission service, FERC will resolve the disputes pursuant to section 211 of the Federal Power Act, unless the parties mutually agree to an alternative procedure for binding dispute resolution (i.e., TVA will not assert that FERC lacks jurisdiction under section 211 to resolve disputes). It should be emphasized that FERC already has jurisdiction to set rates, terms and conditions of transmission service for all other users of its grid that are not subject to the limitations of the anti-cherry-picking provisions of section 212(j). Thus, this aspect of the Plan does not expand FERC's jurisdiction to any significant extent or compromise TVA's ability to charge fully compensatory rates for the services that it provides. Nor does it compromise TVA's ability to meet all of its other obligations under the TVA Act and its bond indentures. What it does do, however, is make it clear that TVA must meet the same standards in setting rates, terms and conditions of transmission service for the Noticing Distributors as it must already meet for other users of the TVA grid.

The Noticing Distributors do not wish to imply that it is likely that there will be disagreements over the proper implementation of the standards applicable to the transmission service to them. TVA has published Transmission Service Guidelines that identify the available services and parallel the FERC-promulgated pro forma Open Access Transmission Tariff that public utilities throughout the country are required to implement. Therefore, much of the service will likely be in accordance with the "off-the-shelf" terms already established by TVA. However, an example of a potential issue that

[6] See footnote 2 of the Plan.
[7] FERC has repeatedly rejected this TVA position. *See, e.g.*, *East Kentucky Power Cooperative*, 114 F.E.R.C. ¶ 61,035 (2006).

has arisen in the past will illustrate the importance of having an independent arbiter available, if necessary, to resolve disputes. The issue arose because TVA Transmission Service Guidelines include in the costs of "transmission" both the entire transmission grid and many of the local facilities used in providing service. So long as everyone is paying on the same basis and sharing in the costs of each other's local facilities, this can be appropriate. However, if TVA takes the position that a Noticing Distributor should be required to pay for 100% of the costs of the local facilities used to serve it, so that the other distributors are no longer sharing in the costs of the Noticing Distributor's local facilities, the Noticing Distributor should not be required to continue to pay a share of the local facilities of the other distributors. Otherwise, it is effectively a discriminatory double charge to the Noticing Distributor. Of course, we are not suggesting that this issue needs to be addressed by the TVA Board, but it illustrates the importance of the Plan's inclusion of a suitable mechanism for resolving such implementation details as a fallback, in what we hope will be the unlikely event that the parties are not able to resolve such issues themselves. We stress, however, that the Noticing Distributors taking transmission service expect to pay fully compensatory rates for transmission services in accordance with the applicable standards set forth in the Plan.

The Plan provides for a potential revenue stream to TVA for transmission service to departing distributors. The current TVA position is that distributors can give contractual notice and thereafter depart the TVA system, but that TVA will not facilitate such action by agreeing to provide transmission service to the departing distributor. By taking this position, TVA is turning its back on the potential stream of revenue it could enjoy from providing transmission service to departing distributors. This potential revenue stream could be significant in the long-term, assisting TVA in covering its costs for transmission facilities already built and in place.

Conclusion

The Noticing Distributors again thank the new TVA Board for inviting participation in this hearing by all interested parties, including the Noticing Distributors. We hope that upon completing its review, the Board will agree that the consensus Joint TVPPA Plan offers a valuable opportunity for TVA. We urge the Board to approve it today and to direct its Senior Management to proceed immediately with the development of contracts to be ready for formal approvals within sixty days. If more time is needed to implement the more complex elements of the Plan as it applies to the non-noticing and future noticing distributors, we respectfully request, in light of the urgency of financial decisions and commitments that the Noticing Distributors must make, that contracts to implement the Plan at least for those six distributors be completed within sixty days.

Thank you again for the opportunity to be heard and for the Board's willingness to address and resolve this important matter.

Respectfully submitted,

Gerald W. Hayes Gerald W. Hayes, President and CEO Warren Rural Electric Cooperative Corporation	*David R. Clark* David R. Clark, General Manager Paducah Power System
Gary Dishman Gary Dishman, CEO Monticello Electric Plant Board	*John A. Humphries* John A. Humphries, P.E., Superintendent Princeton Electric Plant Board
William J. Ray William J. Ray, Superintendent Glasgow Electric Plant Board	*James M. Allison* James M. Allison, General Manager Duck River Electric Membership Corporation

Joint TVPPA Plan

This is a deliberative pre-decisional DRAFT document of TVPPA. It represents the collaborative work of the TVPPA Steering Committee, and is proposed to be a Framework for negotiations with TVA executive management.

DRAFT – May 18, 2006

Essential Elements of a Comprehensive **Non-Legislative** Plan for Partial Requirements, Transmission Access, and Asset Ownership[1]

a. Immediate transmission access waiver for current noticing distributors (with the following conditions)

b. Current and future noticing distributors receive just and reasonable, non-discriminatory transmission access at FERC proforma tariff rates, terms, and conditions.[2] Transmission service and/or interconnection with coordination services to be available to current and future noticing distributors at the end of the cancelled contract term. Transmission service arrangements may include Network Integration Transmission Service, Firm Point to Point Transmission Service, and other types of transmission services, including Ancillary Services, identified in TVA's Transmission Service Guidelines.

c. Current and future noticing distributors relinquish non-transmission related programmatic services and benefits, such as economic development and energy services programs, effective at time of formal notice of contract cancellation.

d. Current and future noticing distributors relinquish all preference rights to output of TVA's current heritage generation assets and future TVA generation assets at the time of formal notice of contract cancellation, but continue to receive power and energy at prevailing system average rates for the remainder of the cancelled contract term.

e. Following the expiration of the cancelled contract term, current and future noticing distributors relinquish rights to future surplus power from TVA heritage generating assets for the portion of their load removed from the TVA system, but by mutual agreement, may purchase power

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[1] Three classes of distributors are referenced

- Current noticing distributors
- Future Noticing distributors (includes future partial requirements distributors)
- Non-noticing distributors

[2] TVA shall provide transmission service at rates, terms and conditions that are just and reasonable and not unduly discriminatory or preferential, in keeping with the requirements and standards of sections 205, 206 and 211 of the Federal Power Act. If the parties are unable to agree on the rates, terms and conditions of transmission service, FERC will resolve the disputes pursuant to section 211 of the Federal Power Act, unless the parties mutually agree to an alternative procedure for binding dispute resolution (i.e., TVA will not assert that FERC lacks jurisdiction under section 211 to resolve disputes).

and energy from the TVA system at negotiated market-based prices, terms, and conditions.

f. Current noticing distributors cancel their entire full-requirements power supply contract with TVA. Future noticing distributors retain the option to cancel only a portion of their TVA contract (partial requirements).

g. Current noticing distributors have a one-time grace period (180 days) to reconsider, without consequence or increased costs, the withdrawal of their current contract cancellation notice in order to receive the same benefits, terms and conditions developed for future noticing or non-noticing distributors. Future noticing distributors receive no grace period once formal contract cancellation notice has been given for any portion of their contract.

h. TVA will not seek to recover stranded costs from any noticing distributor. However, at the end of the cancelled contract notice period, current and future noticing distributors will seriously consider good-faith offers from TVA of short-term quantities of power and energy at negotiated rates for a portion of the load removed from the TVA supply plan (to mitigate impacts of fixed-cost shifting to non-noticing distributors).

i. Non-noticing distributors retain exclusive rights to continued forward purchase of output of TVA's current heritage generation assets and future TVA generation assets.

j. Future noticing distributors have the right to cancel a portion (0% to 100%) of their TVA contract (partial requirements), under similar conditions and with similar rights for the cancelled load, as current noticing distributors, subject to ratable departure levels.[3]

k. Partial requirements to include options for distributor self-generation or purchase from a supplier other than TVA.

l. TVA and non-noticing distributors will develop arrangements for distributor ownership/financing for a portion of TVA's current heritage generation assets and future TVA generation assets.

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[3] Ratable departure levels to be developed and described that allow future noticing distributors to implement partial requirements power supply arrangements. Annual ratable departure level to be adequate to allow reasonable and sufficient optionality for multiple distributors to evaluate and implement partial requirements options, yet limited to the extent that undue cost shifting among distributors is mitigated, and adverse ratings of TVA bonds are minimized. Current noticing distributors would be allowed to remove the entire amount of their load at the time of their contract term expiration.

m. Formal TVPPA Board Resolution and signed commitment by current noticing distributors to actively support timely legislation for a pro rata fence modification.[4]

n. Formal TVA Board Resolution supporting the elements described herein.

o. In the event that timely legislation for a pro rata fence modification cannot be effectively implemented, the foregoing arrangements will be implemented with a lower initial ratable departure level, until legislation for a pro rata fence modification is implemented, at which time the ratable departure level will be reevaluated to reflect TVA's legislated ability to sell wholesale power outside the current fence.

p. The effective date for the transmission access waiver for any current noticing distributors would be at the expiration of their respective contract cancellation period.

q. The effective date for transmission access and partial requirements for any future noticing distributor would be at the expiration of any future contract cancellation period, with the amount of partial requirements limited by the available amount of energy determined by the cumulative ratable departure level (MWh).

r. In addition to the above specific items, TVPPA and TVA will continue in good faith discussions and negotiations to develop a contract for an improved long-term relationship between TVA and the distributors that addresses the following specific issues.
    i. Contract term length – new contract form for all distributors that allows status quo if desired
        1. Layered contracts (multiple term lengths)
        2. Adequate coverage for hedging asset financing
    ii. Pricing methodology for multiple term lengths
    iii. Credits for debt reduction
    iv. Appropriate disposition of Consensus Title issues
    v. Modified rate change and rate adjustment process, including a Fuel Cost Adjustment Mechanism with distributor oversight
    vi. Preservation of Public Power (cost-based) principles in pricing of products and development of ownership models

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[4] Pro rata fence modification means TVA would have the ability to enter into wholesale power exchange arrangements with any wholesale entity, in addition to those identified in the 1959 amendment to the TVA Act, equivalent to the amount of energy (MWh) removed by a current or future noticing distributor from the TVA system, i.e., the amount to be served by a wholesale power supplier other than TVA. The amount of energy to be removed by a future noticing distributor would be limited by the available amount of energy determined by a cumulative ratable departure level.

This is a deliberative pre-decisional DRAFT document of TVPPA. It represents the collaborative work of the TVPPA Steering Committee, and is proposed to be a Framework for negotiations with TVA executive management.

DRAFT – May 18, 2006

Essential Elements of a Comprehensive **Legislative** Plan
for pro rata fence modification (MWh for MWh)

a. TVA and TVPPA to work with Valley Congressional delegation to develop appropriate simplified legislation that provides for a pro rata fence modification that allows a ratable departure level of current and future TVA distributor load.

b. Pro rata fence modification means TVA would have the ability to enter into wholesale power exchange arrangements with any wholesale entity, in addition to those identified in the 1959 amendment to the TVA Act, equivalent to the amount of energy (MWh) removed by a current or future noticing distributor from the TVA system, i.e., the amount to be served by a wholesale power supplier other than TVA. The amount of energy to be removed by a future noticing distributor would be limited by the available amount of energy determined by a cumulative ratable departure level. Current noticing distributors would be allowed to remove the entire amount of their load at the time of their contract term expiration.

c. Ratable departure levels to be developed and described that allow future noticing distributors to implement partial requirements power supply arrangements. Annual ratable departure level to be adequate to allow reasonable and sufficient optionality for multiple distributors to evaluate and implement partial requirements options, yet limited to the extent that undue cost shifting among distributors is mitigated, and adverse ratings of TVA bonds are minimized. Ratable departure levels to be contractual rather than legislative.

d. Formal TVPPA Board Resolution to actively support timely legislation for a pro rata fence modification

e. Signed commitment by current noticing distributors to actively support timely legislation for a pro rata fence modification.

f. Formal TVA Board Resolution supporting the elements described in the Comprehensive **Non-Legislative** Plan for Partial Requirements, Transmission Access, and Asset Ownership

g. Current TVA/TVPPA/TVIC Consensus Title to be evaluated in context of agreements reached in Comprehensive Legislative and Non-Legislative Plans. Appropriate terms and conditions of Consensus Title to be addressed either legislatively or contractually. Appropriate Consensus Title disposition to be determined.

Warren RECC - Hayes

WRITTEN TESTIMONY OF
PRESIDENT AND CHIEF EXECUTIVE OFFICER
OF WARREN RURAL ELECTRIC COOPERATIVE CORPORATION
GERALD W. HAYES
BEFORE
THE BOARD OF DIRECTORS OF THE
TENNESSEE VALLEY AUTHORITY
SUPPORTING IMMEDIATE IMPLEMENTATION OF
THE JOINT TVPPA PLAN
MAY 18, 2006

WELCOME

Mr. Chairman, members of the TVA Board, special guests - Welcome to Kentucky.

INTRODUCTION

I am Gerald Hayes, President and CEO of Warren Rural Electric Cooperative Corporation (Warren) in Bowling Green, Kentucky. During the past six years as President and CEO, my greatest endeavor in serving our membership has been to provide the highest quality electricity at the lowest possible cost.

BACKGROUND

Shortly after I assumed the role of President and CEO, Warren identified long-term power supply as the major strategic issue facing our Cooperative because of rate disparity between Warren and other utilities in Kentucky who purchase power from various suppliers. Warren undertook an extensive study and evaluation of wholesale power options. When we completed our four-year search and evaluation process, staying with TVA was one of the top three options available to Warren.

After further evaluation of the three options, Warren determined that the preferred plan was to become a member of East Kentucky Power Cooperative (East Kentucky). It was a very difficult decision to leave TVA after 62 years. However, our Board and Management Team determined it was in the best interest of Warren's members to become a member of East Kentucky. Subsequently, Warren signed a 33-year contract with East Kentucky in May 2004.

As a member of East Kentucky, Warren will build equity through investment in the generation and transmission assets that serve our needs. We will also have a voice in the decisions that affect our future.

THE EAST KENTUCKY POWER SUPPLY PLAN

As part of the East Kentucky Power Supply Plan, East Kentucky and Warren evaluated two options for transmission service. The first option was for East Kentucky to pay TVA to provide transmission service to the southern portion of the Warren service area where over 80 percent of the load is located. That ceased to be an option when TVA would not provide transmission service to enable East Kentucky to serve Warren. The second option was for East Kentucky to serve Warren through new and existing East Kentucky transmission lines along with reliability interconnections to the existing TVA transmission system. This option offers a more economical choice for transmission service along with increased reliability for the region. It also provides future rate stability for Warren since most of the costs for transmission service are fixed. In addition to the benefits described above, the Plan addresses the need for improvements to the area bulk transmission system which includes part of the TVA transmission system and East Kentucky's need for reliability interconnections. The Plan also integrates Warren's need to upgrade several miles of older transmission lines in the service area.

East Kentucky applied to the Kentucky Public Service Commission (PSC) for a Certificate of Public Convenience and Necessity to construct the transmission lines needed to deliver power to Warren. On October 31, 2005, the PSC approved East Kentucky's proposal to build the new transmission lines called for in the Plan, and we are moving forward aggressively with implementation.

INTERCONNECTIONS WITH TVA

After TVA refused to agree to an interconnection agreement, East Kentucky applied to the Federal Energy Regulatory Commission (FERC) for TVA interconnections for reliability. TVA currently has reliability and interchange interconnection agreements with 13 other generating and transmission entities. TVA also has interconnections in place with East Kentucky at 6 locations. East Kentucky simply asked that 3 additional reliability interconnections be added in the Warren service area. FERC has ordered TVA to provide the interconnections, but TVA has requested a rehearing of the FERC order as a possible prelude to an extended court appeal. This will only cause further delays, uncertainty, and expense for Warren and its members.

Both East Kentucky and Warren have invested a tremendous amount of time and resources into the execution of this plan. Construction of the new transmission lines by East Kentucky, coupled with reliability interconnection agreements with TVA, will provide south central Kentucky with enhanced reliability at the most economical cost. Your decision can help this plan move forward quickly.

JOINT TVPPA PLAN

The TVA Noticing Distributors have worked with representatives of the Tennessee Valley Public Power Association (TVPPA) and TVA management to develop a plan that will be beneficial for all parties. We believe it is a plan that makes good business sense for TVA and allows the Noticing Distributors a definitive way to pursue other options with regard to choosing a wholesale power provider that best meets their individual needs. It also protects the interests of those TVA distributors who wish to continue their relationship with TVA.

The proposed TVPPA non-legislative solution (also referred to as the "Joint TVPPA Plan") will address the various needs of the Noticing Distributors and allow them the options they need to develop the best solutions for their customers with regard to transmission access. This plan will also provide important protections for TVA and benefits for those distributors who elect to retain TVA as their power provider. Pursuant to the Joint TVPPA Plan, Warren and the other Noticing Distributors will also support the enactment of legislation that will give TVA the opportunity to market power outside the fence.

Assuming that the TVA transmission access waiver under the TVPPA non-legislative solution means that East Kentucky will receive interconnections as directed by FERC without further objections or delays from TVA, Warren supports the TVPPA non-legislative solution. We request that the TVA Board not only give permission, but also direct the CEO and legal staff to implement the solution as presented in a timely manner.

CONCLUSION

Warren is simply trying to do what is in the best interest of our members, and we ask for your help in accomplishing this goal. Thank you for your interest in our situation and for taking steps to address these concerns promptly.

Princeton - Humphries

WRITTEN TESTIMONY OF
PRINCETON ELECTRIC PLANT BOARD
GENERAL MANAGER
JOHN A. HUMPHRIES, PE
BEFORE
THE BOARD OF DIRECTORS OF THE
TENNESSEE VALLEY AUTHORITY
SUPPORTING IMMEDIATE IMPLEMENTATION OF
THE JOINT TVPPA PLAN
MAY 18, 2006

WELCOME

I appreciate the invitation to speak at this hearing of the TVA Board to provide the perspective of Princeton Electric Plant Board (PEPB) serving Princeton, Kentucky, a community of approximately 7,500 residents.

PURPOSE

PEPB is requesting the TVA Board to authorize and direct Tom Kilgore, TVA CEO, to enter into contracts with power distributors to implement the plan negotiated and developed by the Tennessee Valley Public Power Association (TVPPA) and TVA senior management, with participation of the Noticing Distributors. PEPB respectfully requests that the contract be finalized and executed within the next sixty (60) days. I hope to explain to you our reasoning for this very important request in the following comments.

PEPB INITIATED WHOLESALE POWER SUPPLY REVIEW IN 2003

Princeton formed its public power entity in 1957 and took power from TVA via Kentucky Utilities transmission facilities for five years starting in 1961. TVA started serving PEPB's load using its own lines in the sixth year of operation. PEPB serves about 4,000 residential, commercial, and industrial customers. Today there are four electric providers inside the city limits of the small town of Princeton.

Currently, TVA rates are nearly 40% higher than both the investor-owned-utility and the non-TVA coop that compete with PEPB within our city limits. In order to attract new businesses and grow our community, it is imperative that Princeton be able to offer the lowest possible rates for reliable electricity. Accordingly, when TVA raised rates over the objection of a majority of its 158 distributor customers in 2003, PEPB initiated a review of its wholesale power supply arrangements.

TVA'S 1997 AGREEMENT IMPLIES TRANSMISSION ACCESS

PEPB and TVA entered into an all-requirements agreement amendment in 1997. The contract provided that after October, 2002, PEPB would have the option of terminating the contract upon five years' notice to TVA. Accordingly, when a thorough study of

Princeton's long-term power supply revealed that there are less expensive sources of reliable power available to Princeton, PEPB exercised its option to terminate the TVA contract, with the expectation that its interconnection with TVA would remain in place, and that transmission service would be available from TVA if needed.

KENTUCKY MUNICIPAL POWER AGENCY

In 2005 Paducah Power System (PPS) and PEPB formed the Kentucky Municipal Power Agency (KMPA) under the Kentucky Interlocal Agreement Act for the purpose of jointly purchasing baseload power from the Prairie State Energy Campus in Washington County, Illinois. The coal-fired baseload plant is expected to be available in 2010 and near the expiration of the wholesale power contract with TVA. The formation of the first joint action agency in Kentucky is expected to provide the opportunity of significantly lower priced long-term arrangements for wholesale power for both communities. Under the arrangements, it is currently expected that the baseload power will be transmitted over the Midwest Independent System Operator grid and the Kentucky Utilities/Louisville Gas & Electric transmission system, with TVA interconnections to remain in place for enhanced reliability for both systems. These additional transmission connections will increase the reliability of the electric system in Western Kentucky. In addition, KMPA will help enable PPS and PEPB to construct peaking power plants within their respective systems that will further enhance reliability. Through KMPA arrangements, to be completed in 2010, PPS and PEPB will be able to offer lower rates and increased reliability to their respective communities.

JOINT TVA/TVPPA WIN/WIN PLAN

I have worked with TVA and TVPPA over the past year to help develop a contractual solution to our transmission issues. This joint plan, which is attached to the Joint Statement of Noticing Distributors for your convenience, makes good business sense for TVA. The plan was initiated by TVA's management and is broadly supported by distributors. It is consistent with TVA's mission and national policy. It protects and strengthens TVA's financial position. The plan allows measured transition into a more competitive posture and healthier position for TVA by allowing its relationship with distributors to be a product of voluntary choices, rather than the exercise of monopoly control. The plan preserves TVA's discretion to set power rates and maintain financial strength. The plan allows for the departure of only a very small amount of load relative to TVA's total system load. With TVA generating resources tight, any relief from the pressures of load growth may well turn out to be economically beneficial to TVA. Included in the plan is support for legislation for limited Two-Way Fence Lowering, which, if adopted by the U.S. Congress, would provide new marketing opportunities for TVA.

Another important benefit for TVA is that the jointly agreed-to plan would avoid the potential imposition by Congress, the courts, or the Federal Energy Regulatory Commission (FERC) of remedies to these matters that might not have the same protections for TVA, such as the limitations on loss of TVA load. The 1997 contract promised an option for PEPB to leave the TVA system, and we believe the option necessarily includes access to TVA's transmission grid. FERC has already ordered interconnections for East Kentucky Power Cooperative in connection with its commitment to provide power supply service to Warren RECC, another distributor who has exercised its option to terminate its TVA contract.

FERC's potential role in resolving any issues regarding transmission rates and terms involves the same type of authority FERC already has over TVA under section 211 for all other users of the TVA grid. Transmission rates, terms, and conditions should meet the same standards as required for all other major grid owners. FERC already has authority over TVA's transmission rates, terms, and conditions under section 211 of the Federal Power Act. Distributors who have given notice to TVA to terminate their wholesale power contracts (Noticing Distributors) will cooperate in resolving any issues by agreement. We are willing to pay just and reasonable rates, but do not believe we should be subjected to double charges. Furthermore, we believe the transmission issues can and should be resolved by mutual agreement, rather than through FERC, Congressional, or judicial intervention, but with recourse to FERC or a mutually agreeable alternative dispute resolution mechanism to resolve any technical details that the parties are unable to settle by themselves.

SOLUTION

PEPB is working hard to secure the lowest priced source of reliable power for its customers. Securing a long-term power supply for Princeton may require the construction of transmission facilities, which obviously takes a considerable amount of time. Accordingly, PEPB needs to finalize in the very near future its plans for obtaining wholesale power. Therefore, we need assurance from TVA now that transmission access and/or interconnection will be available from TVA in accordance with the Joint TVPPA Plan, in order for PEPB to be able to proceed in an expeditious and timely manner on these other related issues.

In conclusion, it is time for TVA and the Noticing Distributors to resolve the transmission issues through execution of a contract that memorializes the arrangement that has been negotiated by TVA, TVPPA, and the Noticing Distributors. The Princeton Electric Plant Board is a community-owned enterprise providing electric services to the Princeton area. We are committed to improving the economic and environmental quality of the community in partnership with our customers, by providing reliable electric power at the lowest rates achievable through innovation, efficiency, and professional operations. TVA helped Princeton in 1961 to develop a public power community, and we ask you again for your help today in a very different way and in a very different environment.

Thank you.

Paducah - McLennan

WRITTEN TESTIMONY OF CHAIRMAN OF THE BOARD OF THE ELECTRIC PLANT BOARD OF THE CITY OF PADUCAH KENTUCKY RAYMOND E. MCLENNAN BEFORE THE BOARD OF DIRECTORS OF THE TENNESSEE VALLEY AUTHORITY ON SUPPORTING IMMEDIATE IMPLEMENTATION OF THE JOINT TVPPA PLAN MAY 18, 2006

Introduction

Chairman Sansom and Members of the TVA Board, I am pleased to be able to discuss with you today the issues facing Paducah Power System and our ratepayers. I want to give you a little background, a summary of how we currently feel and a possible solution to ease those feelings.

Background

The Electric Plant Board of the City of Paducah has been a distributor of TVA power since 1962. Before that time, Paducah was served by Kentucky Utilities Company. The reason we left Kentucky Utilities was the high cost of wholesale power and the effect that was having on our customers. It also was having a negative effect on our search for new businesses to locate in our area. The people of Paducah voted to condemn and ultimately purchase the assets of Kentucky Utilities in Paducah. They began a partnership with TVA, purchasing all of their power needs from TVA.

In 1997, Paducah Power System signed a 5 plus 5 contract amendment with TVA. This contract said that if we did not give notice for at least five years, then we could give a five-year notice, at that time, with no stranded costs charged to the leaving distributors. We gave notice to TVA in December of 2004 that we would leave in December, 2009.

The Problem

We are purchasing an interest in a large new coal-fired generating plant in Southern Illinois. We will also need to either purchase or generate additional power supply over this base amount. We need to have assurance that we can obtain reliable delivery of that power at a reasonable cost. We are spending a lot of money on this project and need firm commitments from TVA as soon as possible. It would expand our options to have transmission access over the TVA system. We also would like to have an interconnection with TVA's grid system for reliability purposes. If Paducah Power becomes a transmission customer of TVA, we would pay TVA to transport someone else's power to Paducah just as Kentucky Utilities did when it had the right to use the TVA grid to transport power, as they did when they served Paducah. Paducah Power System does not touch any other TVA served distributor but is surrounded by Jackson Purchase Co-op. Jackson Purchase gets all of its power from Big Rivers Co-op which has interconnection and transmission rights with TVA. It is not fair to penalize the customers of Paducah, Kentucky because they became a TVA distributor. It would be fair to assume that Paducah Power System would have all of the rights and privileges that it had before it partnered with TVA when it leaves, especially considering we have lived up to ALL parts of every contract that we have signed with TVA. However, that is not what TVA has offered in the past. Instead, TVA would have treated the customers of Paducah as second class citizens and made them pay to construct transmission lines to other providers because we were NOT allowed to pay to use the TVA grid to get our power delivered. I ask you, is this FAIR?

Conclusion and the Answer

The Paducah Power System simply wants you to direct the CEO to offer transmission and interconnection services to us at just and reasonable rates. The Joint Plan that TVA and TVPPA have worked out would be a fair and reasonable approach to this problem. The departure of the Paducah Power System will only reduce TVA's energy sales by less than 0.5% in 2010. This is much less that the average growth in energy sales TVA experiences in three months. There is simply not time for this matter to wind its way through other legal or Congressional solutions. I hope that this new board will have the vision to propel TVA into a bright new beginning, not letting history set your boundaries but freeing you to explore new territory.

To the Board members of TVA who believe that the fence should be lowered for the amount of sales lost due to the noticing distributors, I say that Paducah Power System will work with others to get Congress to allow this to happen, as will all Noticing Distributors and TVPPA under the Joint TVPPA Plan. Just remember that what is leaving is not a large amount of load, and the transmission and interconnection rights and other non-legislative elements of the Plan need to be done first and separate from the legislation, which will take more time. Paducah Power cannot wait. Please do what is right and just.

Thank you for the opportunity to present these feelings of Paducah Power System to this new TVA Board.

Duck River - Allison

WRITTEN TESTIMONY OF
GENERAL MANAGER OF
DUCK RIVER ELECTRIC MEMBERSHIP CORPORATION
JAMES M. ALLISON
BEFORE
THE BOARD OF DIRECTORS OF THE
TENNESSEE VALLEY AUTHORITY
SUPPORTING IMMEDIATE IMPLEMENTATION OF
THE JOINT TVA/TVPPA PLAN

MAY 18, 2006

Introduction

Chairman Sansom and Members of the TVA Board, I am pleased to be here today. Duck River Electric is the only non-Kentucky TVA distributor with an outstanding contractual notice to TVA. I am here today to discuss with you how and why this came to be, the status of our current situation with respect to our contract with TVA and to show our support for the efforts of TVA management, the management and leadership of TVPPA and the other noticing TVA distributor systems in resolving the transmission service issues.

Background

Duck River Electric Membership Corporation (DREMC) serves approximately 67,000 members in all or parts of fifteen counties in south-central Tennessee. Organized as an electric cooperative under the laws of the State of Tennessee, DREMC is governed by a fourteen member Board of Directors elected by the general membership. DREMC is headquartered in Shelbyville, TN and also has six other offices located throughout its service territory. Historically, DREMC's membership, with a few notable exceptions such as the University of the South and the Jack Daniels Distillery, has been predominantly residential and small commercial in nature. Over the last several years, however, several large industrial loads have located in DREMC's territory (Nissan Motor Assembly Plant, Decherd; M-Tek, Manchester; Cytec-Avecia, Mt. Pleasant; etc.). DREMC's peak demand is approximately 400 MW, making it one of TVA's fifteen largest customers.

DREMC has followed with great interest TVA's struggle to reduce its debt. As early as 2000, following then-recent TVA revelations it was not achieving the critical debt reduction targets it set for itself in its 1997 strategic plan, DREMC formally and in writing went on record encouraging TVA to increase its rates and dedicate such increases strictly to debt reduction. DREMC was and still is concerned that TVA should not waste any more of the remainder of its contractually provided for monopoly period spanning the 1997-2007 timeframe (even longer in the case of the vast majority of distributor systems which have yet to give the required five year notice), during which TVA's status as exclusive electric wholesale supplier to the Tennessee Valley is assured – that it should aggressively pay down its debt while <u>all</u> the distributors are still around and can be contractually required to participate in the pay down of the debt largely stemming from previously failed TVA nuclear projects. However, TVA did not act on DREMC's encouragements at that time.

Rather, as the date of October 1, 2002 rolled around, DREMC watched as several other TVA distributors gave the required five year contractual notices to TVA. Those giving notices included DREMC's neighboring cooperative system to the west, Meriwether Lewis Electric Cooperative, and several in the Commonwealth of Kentucky. Thus, DREMC noted with growing interest as several members of the TVA distributor group, including one of its closest neighbors, indicated their desire and willingness and prepared to exit the TVA system, leaving their respective shares of TVA's massive debt behind (as specifically provided for in their contracts with TVA) to be paid by the remaining TVA distributors.

DREMC performed a thorough and exhaustive review of its options. Not only did DREMC conclude that it could, in fact, secure all of its wholesale power needs from sources other than TVA at prices well below the prices charged by TVA (up to 30% below TVA's price in early-mid 2003), but even more importantly it concluded that it would be a terrible mistake for DREMC to remain with TVA should any significant portion of TVA's other distributors begin to exit the TVA system. Such a situation would result in the obligation to repay TVA's massive debt being concentrated on the shoulders of the fewer and fewer systems remaining with TVA, thereby triggering rapid and dramatic escalation in the already high rates charged by TVA for wholesale power. Again, after seeing several systems providing contractual notice to TVA, in August 2003 DREMC gave its required five year notice to TVA.

However, DREMC emphasized that it was providing the notice as a defensive measure in order to protect its membership from the adverse consequences of TVA losing significant amounts of load. DREMC emphasized to TVA in the notice itself a desire to remain a long-term customer of TVA and a willingness to work exclusively with TVA (as opposed to committing to alternative power suppliers) for the first two years of the notice period in seeking ways to address DREMC's concerns, should TVA be willing to reciprocate in its actions. Rather than reacting favorably to DREMC's offers and what it acknowledged were very legitimate concerns, TVA reacted in just the opposite manner in what DREMC regarded as a punitive manner – terminating programs, calling loans due, stating it would remove DREMC load from its planning efforts while at the same time stating it would not commit to the transmission access needed for DREMC to plan, etc. DREMC regarded such actions as efforts by TVA to try to pressure DREMC into rescission of the contract notice. The TVA actions forced DREMC into the position, contrary to what DREMC had sought and offered in its letter of notice, to start making plans of its own; since TVA was steadfast in its refusal to continue to include DREMC in the TVA programs and planning efforts, DREMC had no choice but to begin such efforts on its own, working with other interested parties as such were identified. TVA's heavy-handed tactics, while clearly intended to try to "bully" DREMC into submission, had just the opposite effect and, as a result, the positions of both parties seemed to harden and the gap seemed to widen. This culminated in TVA's refusal, due strictly to DREMC having given notice, to address a serious situation causing great hardships to a segment of DREMC's membership, wherein several thousand members experienced repeated and lengthy outages of service on the coldest days of the winter due to repeated failures on TVA transmission lines serving the substation which provided service to these members of DREMC. Once again, DREMC regarded TVA's refusals to appropriately deal with the situation on its transmission system as being just further efforts to bully DREMC into withdrawing its contract notice. Only upon threat of litigation by DREMC, and after several thousands of dollars in fees to legal counsel to force TVA's hand, did TVA relent and agree to appropriately address the situation on its transmission system causing these repeated outages on the coldest days of the year to this group of DREMC members.

While it is indeed unfortunate that the TVA-DREMC relationship had to deteriorate to this point, it also seems that the new found cooperation shown by TVA in agreeing to address this transmission reliability situation was the beginning of better times in the relationship between the parties. This seeming willingness on the part of TVA to now seek to find reasonable, mutually advantageous solutions to the admittedly very legitimate concerns of DREMC opened new channels of communications and additional discussions ensued. Of particular note, DREMC would observe that the personal involvement of TVA's General Counsel, Maureen Dunn, and of TVA's newly appointed President, Tom Kilgore, had very positive impacts on its efforts to get its dealings with TVA back on reasonable terms. While TVA certainly did not do anything that could even be remotely regarded as "giving away the store" on any issue, it did move away from the "my way or the highway", "take it or leave it", "punish until submission" approaches that had characterized the TVA reaction to DREMC's notice up through that point in time.

As DREMC neared the two year point in its five year notice period, the point which it regarded as being the point in time where due to necessary planning lead times it would need to decide if it wished to procure its power supply from an alternative source, ongoing discussions between TVA and TVPPA over a potential long-term contract stalled. DREMC had participated actively in these discussions as such offered the promise of potentially solving the major issue giving rise to DREMC's decision to give notice to TVA – the potential for TVA to lose significant load in the coming years. At the same time, the wholesale power market had escalated significantly and the opportunities for DREMC to cut its wholesale power bill by the large amounts that had been possible just two years earlier (by up to 30%) had decreased substantially; while savings were still possible, the magnitude of such possible savings had dropped and the risks associated with such opportunities had increased. And the all important transmission access issues still remained unresolved.

As a result of all of these developments, DREMC approached TVA about the possibility of extending the date of the termination of its contract notice. TVA indicated its willingness to consider such and eventually the parties agreed to extend the notice period by two years, to August 2010. As part of the extension agreement, TVA agreed to the reinstatement of all the various programs that TVA had unilaterally revoked and suspended two years earlier. As part of this agreement, DREMC agreed that should it leave the TVA system in August 2010, TVA expenditures for the reinstatement of such programs would be reimbursed to TVA by DREMC. DREMC had made this imminently reasonable offer to TVA two years earlier, but such had been rejected by TVA at that time. Obviously, DREMC was and remains pleased with TVA's willingness to deal with such issues on their merits and in a spirit of seeking mutually satisfactory solutions, quite a different approach than that which had been demonstrated by the "old" TVA two years earlier. Again, DREMC credits the leadership of Mr. Kilgore and Ms. Dunn for this change in TVA's approach.

The Current Situation

DREMC will remain a TVA distributor at least until August 2010. Throughout its efforts to evaluate this issue, DREMC has attempted to set aside the "emotional" aspects of the matter and deal with this issue strictly on economic and business terms. DREMC has no animosity of any type toward TVA and in many ways it very much hopes that TVA can present itself in such a manner that it will become obvious between now and 2010 that remaining a TVA distributor is in the best interests of DREMC and its members. In all sincerity, unlike many of the noticing systems in Kentucky, DREMC has not made a decision to either exit or remain a part of the TVA system. Rather, it has made the decision to keep its options open for as long as it can – and then to make a decision based on what is the best long-term economic and business option for DREMC and its members.

While today is a hearing on the transmission access issue, and I will comment on this issue of extreme importance in a moment, it might be prudent to briefly mention some of the other issues that DREMC will closely evaluate as it goes about making its decision.

The Price – Clearly this is a major factor. While TVA's price, relative to the other alternatives, has improved in the last two to three years, DREMC still pays TVA a price for wholesale power that is approximately 13% above the median price paid by Cooperatives across the US and that places DREMC in the highest 27% of cooperatives nationally with respect to the price paid for wholesale power.* TVA's wholesale price must be competitive with other sources to retain load in the long-term.

The Debt – Clearly this is related to price. TVA must continue in a major way its debt reduction efforts while it still has a large load base across which to spread these fixed costs. Fixed financial obligations at the levels currently held by TVA are a major risk factor to both TVA and distributors as TVA's protected monopoly period comes to a close, unless new and significant contractual protections are mutually agreed to by the parties.

The Relationship – Will distributors be true partners with TVA? Will TVA return to the heavy handed tactics of the past? Will opportunities for distributors to build equity in generation and transmission assets come to fruition? What will the next generation of TVA-distributor contracts look like? These are all questions that will define the relationship in the future.

Transmission Access

DREMC is located "smack-dab in the middle" of the TVA system. It has twenty-three points of delivery from the TVA transmission system and that number increases just about every year. Even if DREMC built and owned the generation resources needed to supply all its own load within its own service area, transmission access would be needed to get these resources delivered to the load. In short, DREMC's right to give notice under its contract is meaningless without transmission access.

DREMC is of the view that the 1997 contract option of notice and exit carries with it the right to transmission access on just and reasonable terms. It believes that, if necessary, such would be ordered by the courts. However, it also recognizes that TVA does not necessarily agree and that, because of this, enforcement of such rights could be a long and expensive proposition. Furthermore, it also recognizes that the effort also might all go for naught as DREMC has not yet even decided that it wants to leave the TVA system.

Likewise, DREMC is of the opinion that the distributor exit model advocated by TVA prior to the negotiation of the Joint TVA-TVPPA Plan cannot be allowed to survive. It has been TVA's position that the 1997 contract does in fact give the right to distributors to exit the TVA system, but that such right extends only to those systems that completely separate themselves from the transmission system. The fact that this approach is completely incongruous with the US national policy and that such makes no sense economically or otherwise is dealt with in the Noticing Distributors' Joint Statement and will not be repeated here. However, the practical implication of this TVA position is that the TVA system would erode from the outside in, like an onion peeling off in layers, as systems on the periphery of the TVA area extend other suppliers' transmission systems into their areas to avoid the need to interconnect with TVA. Then the next layer does the same thing as the non-TVA transmission systems get ever-closer to their system, making direct connection economically possible. As this "peeling of the onion" continues, payment of TVA's fixed costs, including its debt, would become concentrated among those systems located in the layers of the onion not yet peeled.

And guess which system lies near the middle of the onion, one of the systems at greatest risk as the onion gets peeled away? DREMC. This is why DREMC can not sit idly by and allow TVA to impose this exit model on its distributors. While to date this transmission access issue may have been a concern primarily to the Kentucky members of this Board, I hope this discussion illustrates that long-term it should be an even greater concern to those Board members who call the core of the TVA service area home, those representing areas that would be left as the onion peeled away.

One hearing this testimony might think that the solution for the "peeling of the onion" issue that so very much concerns DREMC is obvious – that TVA simply should retreat to a monopolist's strategy and try to prevent any system from leaving. The problem with that is that it is simply no longer possible. That model just does not exist anywhere in the country any more with respect to the wholesale provision of electricity – national policy is clearly in just the opposite direction. The "genie is already out of the bottle" so-to-speak. Long before Congress passed the new section 211A of the Federal Power Act last summer providing broader access to the TVA grid, the 1997 contract amendments between TVA and the distributors moved TVA closer to the real world by clearly and unequivocally giving distributor systems the right to leave. And these clearly give distributors the right to do so without any additional compensation to TVA or other distributors after the ten-year waiting period for any unpaid fixed costs they leave behind, including their respective "shares" of TVA's large debt. In industry-speak, they will have already met their obligation for paying any "stranded cost" charges. Departures from the TVA system are going to occur. The only questions remaining are how the departures will occur ("peeling the onion" from the outside in or more evenly distributed across TVA's area; new transmission lines built to the departing load by others with TVA losing all revenues or with TVA receiving some revenues from the sale of transmission services; all or nothing system departure decisions or TVA providing partial requirements?) and at what rate the departures will occur (open-ended as is now the case, with distributors controlling the all or nothing "notice or no notice" decisions, or in mutually agreed upon measured, controlled steps with only limited amounts of TVA load able to depart each year?). And such departures are not necessarily all bad. TVA could derive some benefit from some departures as it moves toward needing to add more generating capacity. If nothing else, TVA could benefit from the lessons learned by "dipping its toe" in the real world of wholesale competition by having to compete for the business of a few of its distributors.

DREMC has been patient with respect to the need to get the transmission access issues resolved in a manner that addresses the concerns of all involved. And we believe that patience has paid off. Under the leadership of Tom Kilgore of TVA and Jack Simmons of TVPPA, a new approach has been negotiated. It is supported by the noticing distributors, the staff and membership of TVPPA and the management of TVA. It is a negotiated solution, one that is a series of compromises. It does not give DREMC everything we would like to have, and frankly, it does not give us everything we think we would get if we took the issue to court or perhaps even to the Congress for solution.

But two things it does have that other alternative solutions do not are immediacy and certainty. It is ready to be put in place right now, and we all know what it entails. All that is awaiting is this Board directing or authorizing the TVA management to proceed with implementation. DREMC believes it is a good solution. As a system that may or may not leave TVA pursuant to our notice, we believe it protects our interests either way.

It would force us to make a decision one way or the other fairly quickly, but we think that is a fair and reasonable requirement on the part of TVA. If we elect to stay, we would know the consequences of that action and the rights to transmission access we would have in the future. Likewise, if we elect to exit, we would know what consequences and risks that decision would entail, but we would also know that transmission access would in fact be available on just and reasonable terms to us in 2010. And it provides a significant degree of protection in that it provides for a measured, controlled rate of departure from the TVA system, an approach that would avoid the catastrophic potential of an uncontrolled peeling of the onion from the outside in, the only other alternative available to distributors even being acknowledged by TVA. It also provides for a manageable transition into the competitive world for TVA and its distributors.

DREMC very much appreciates the opportunity to appear before this Board. We actively encouraged and supported the changes to TVA's governance structure that led to this new Board structure, and we believe that the new structure will serve TVA, the distributors and the Tennessee Valley well. We have worked closely and cooperatively with your management team to negotiate an innovative, mutually satisfactory and imminently reasonable solution to a major problem facing us today. We, once again, encourage you in the strongest possible terms to immediately act to direct or authorize your management team to implement this solution to the transmission access issue.

* U.S. Department of Agriculture, Rural Utilities Service, Borrower Statistical Profile, 10/17/05; National Rural Utilities Cooperative Finance Corporation, Key Ratio Trend Analysis, 08/04/05.

Glasgow - Kay

WRITTEN TESTIMONY OF SUPERINTENDENT OF THE ELECTRIC PLANT BOARD OF THE CITY OF GLASGOW, KENTUCKY WILLIAM J. RAY BEFORE THE BOARD OF DIRECTORS OF THE TENNESSEE VALLEY AUTHORITY ON TRANSMISSION SERVICES FOR EXISTING POWER DISTRIBUTORS WHO WISH TO PURCHASE POWER FROM NEW WHOLESALE POWER PROVIDERS MAY 18, 2006

Introduction

Chairman Sansom and Members of the TVA Board, I am pleased to be able to discuss the issues facing the people of Glasgow, Kentucky, in their quest to find a lower cost alternative to TVA wholesale power, even though I am unable to appear at the hearing in person. I want to discuss our reasons for making the decision to shop for alternative power supply and the TVA policies that until now have made that process nearly impossible. Finally, I will offer a suggestion on how you can act quickly to remedy the problem in a manner that protects TVA and is fair to all of TVA's distributors, whether they choose to stay or obtain power elsewhere.

Background

The Electric Plant Board of the City of Glasgow (EPB) has been a distributor of TVA power since 1962. Before that Glasgow was served by Kentucky Utilities Company. In the late 50's and early 60's the people of Glasgow took it upon themselves to condemn and ultimately purchase the assets of Kentucky Utilities in Glasgow such that they could create the EPB and provide for, what they considered then, a better set of economic circumstances in Glasgow through the purchase of low-cost electric power from TVA.

The people of Glasgow were right about that decision. TVA's rates and programs did create a fertile field for the development of Glasgow's economy. However, as TVA began to make big mistakes in the commencement and subsequent cancellation of several nuclear generation facilities and other mistakes that resulted in dramatic increases to the cost of their wholesale electric power, TVA's rates compared to the rates of Kentucky Utilities and other wholesale energy providers became a big problem for Glasgow's economy. By the late 90's, the people of Glasgow were again looking to make a move toward lower cost electric power.

In 1997, when TVA was discussing a rate increase with all of the distributors, there was a great deal of dissatisfaction among the group relative to the need for the increase. As a way to draw agreement from the distributors, a new power contract format was offered which included the right to terminate the agreement upon five years notice so long as we waited at least until October 2002 to give that notice. The contract also provided us with an assurance that we would not be charged for any stranded investments by TVA so long as we honored the 2002 + five year term of the agreement. Nearly all distributors, including Glasgow, accepted this offer. A little over a year after the October 2002 date, Glasgow EPB, at the behest of its customer/owners, gave TVA notice of its intent to exercise the terms of the contract and leave after five years, in December 2008.

The Problem

Now, when a municipality wants to leave one power supplier and purchase from a new one, it is commonly known that the system will not be pulling up all of its poles and substations and actually moving somewhere else. The thousands of homes and businesses served by the Glasgow EPB know that, and TVA knew that as well when it offered the 1997 contract. Rather, reason dictates that Glasgow stays where it is and that it purchase transmission services from its existing transmission provider (TVA). That means it pays TVA to transport someone else's power to Glasgow. This is exactly how the electric power market operates everywhere else in North America, but TVA in the past has had difficulty facing this reality. In stark contrast to its original mission, TVA in recent years has sought to squash competition and thumb its nose at the market by refusing to provide the transmission services necessary to facilitate robust competition in the electric power marketplace. This is an affront to the heritage of TVA and to the future of the 7,000 homes and businesses served by the Glasgow EPB.

The TVA Mission Envisioned By Its Creators

The TVA that you now find yourself controlling was conceived by the great Senator from Nebraska, George W. Norris. He convinced President Roosevelt that TVA was necessary and, together, they created a "corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise." Their intention was for TVA, and all public power systems that they served, to become the catalyst that would cause a chain reaction of economic development and prosperity in the Tennessee River valley region. They also knew that this public corporation could act as a battering ram to break up the power trusts that were monopolizing the early electric power market and artificially inflating costs through their complex holding companies and corruption. Both Senator Norris and President Roosevelt would be ashamed and angry that in recent years, TVA has acted very much like the power trusts it was designed to destroy in the 1930's.

TVA was meant to be a symbol of democracy's potential to improve the lot of the common man. George Norris used that philosophy as he pleaded with Roosevelt and his fellow Senators to approve the TVA Act. His urging of, "One means by which democracy can combat the forces of entrenched and organized greed is through the use of government," had much to do with TVA's creation. One of the original TVA Board Members, David E. Lilienthal, felt so strongly about TVA's symbolism as a democratic achievement that he entitled his book, *TVA - Democracy On The March.*

Today, TVA has the opportunity to regain its position as an icon of democracy. Until recently, TVA had been trying to build an unbreakable enclave of territory and customers by adopting rates and policies which make it practically impossible for existing customers to have any choice of power suppliers. This made TVA an icon for something chillingly different from what Roosevelt, Norris, and Lilienthal envisioned. However, you can turn the corner on TVA's march away from the flexibility and initiative that it was created to embody by approving the Joint TVPPA Plan developed under the new leadership of TVA's Acting CEO, Tom Kilgore, and its General Counsel, Maureen Dunn, together with the initiative and leadership of TVPPA and input from the Noticing Distributors.

Conclusion And Prayer For Relief

The Glasgow EPB simply wants you to immediately direct and empower TVA management to offer transmission services to it at just and reasonable rates, so that Glasgow EPB can complete its agreements for alternate power supply. Yes, there are issues relative to providing a solution which will be applicable to all TVA distributors, and if you approve the Joint TVPPA Plan today for immediate implementation, Glasgow EPB's needs will be met. But one way or another, the Glasgow EPB needs to be dealt with now rather than later. What we are asking will not hurt TVA or the other TVA distributors. The departure of the Glasgow EPB will only reduce TVA's energy sales by less than 0.5% by 2010. This is much less that the average growth in energy sales TVA experiences in three months! So, this departure will only give TVA, and you, a very brief respite in your monumental plans to provide additional electric generation for the customers who remain. Our request will also preserve considerable revenue for TVA as we expect to pay fully compensatory rates for the transmission services we ultimately expect to utilize. There is simply not time for this matter to wind its way through an additional machination. Your failure to act on this matter immediately will be a decision in itself.

However, if you give us the relief we ask, you can prove to TVA and the other distributors how the market can work. We would also be pleased to continue to work with you and TVA management on ideas that could be very beneficial to TVA. For example, we would be happy to share specific suggestions for how innovative rates can lead to improved system load factors which will dramatically reduce TVA's need for expensive natural gas fired peaking generation. It is certain that Roosevelt and Norris would have liked the idea of one of the distributors becoming the same sort of catalyst for changing the TVA "trust" as they originally intended for TVA itself to change the power trusts of the 1930's.

Thank you for the opportunity to expound on the issues relative to Glasgow's desire to improve its prospects for the future through purchasing power from a new wholesale power supplier, while also supporting the protections and opportunities for TVA and the other distributors contained in the Joint TVPPA Plan.